



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **201330038**
Release Date: 7/26/2013

Date: March 30, 2013

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.36-00; 501.36-01

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Holly O. Paz
Director, Exempt Organizations
Rulings and Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: March 20, 2013

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = Executive Director/Founder/President
C = Name of Organization
O = State
Q = Date

UIL:

501.36-00
501.36-01

Dear :

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Issues

Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons stated below.

Facts

You were incorporated on Q in State O. Your original purpose in pertinent part is to primarily support C financially and provide job training for individuals with special needs. You amended your articles of incorporation to include section 501(c)(3) purposes.

B is your founder, Executive director, president and secretary. You have two other

Letter 4036(CG) (11-2011)
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individuals on your governing body. One serves as your accountant and treasurer. The third is an unpaid director who attends meetings as necessary.

C is a non-profit organization providing educational services to special needs individuals. B works full time at C as a career instructor. B intends to take a leave of absence from C to open and operate you. B's hobbies include garage sales and consigning clothing.

Your primary activity is the operation of a consignment store open to the public. B will handle all aspects of the business and may chose to employ others to help with the day to day aspects of operating the store. B will, recruit consignees for the store, manage all future employees and provide job training to individuals with special needs. The store is located in a strip mall and will be open to the public. Currently you have store hours from 10am to 6pm on Monday and Tuesday and from 11am to 5pm Wednesday through Saturday.

About % of the store merchandise is acquired through consignment from individuals. Your consignment contract provides that the consignor receives % of the sales price and you retain the remaining %. The merchandise is priced at % of the cost to purchase the item new. Merchandise not sold within the contract period, two months from the date of consignment must be picked up by the consignor or the merchandise will become your property.

The remaining % of your store's merchandise is acquired by B from garage sales. B purchases goods that she is confident can be sold for double the price paid.

Your job training program is an extension of programs offered by C. B instructs C on the skills required. C guides the special needs individuals who practice skills at C. The skill tasks include sorting, hanging items, stocking and labeling, pricing and janitorial duties. The supervisors at C select special needs individuals to come to your store. You have no set training schedule. The special needs trainees are welcome during the hours you are open. B must be trained in C's adult program before trainees will be permitted to be with B without C's staff present. The amount of time spent by trainees varies from 30 minutes to a maximum of two hours per day. The maximum time spent by any one individual was three hours per week. The number of trainees varies from one to six.

B and your accountant are compensated for their duties. B and other board members also initially received a % discount on merchandise purchased in your store. You have since discontinued this practice. You hope to hire two other individuals at minimum wage. Trainees are not compensated. However they do earn tickets that can be redeemed for store merchandise. Once your sales reach a level where you can meet your rent, utilities, pay a salary to B and your accountant you will be able to pay

the special needs trainees.

Your projected income is entirely from merchandise sales. Approximately % of your projected expenses are salaries and wages, approximately % occupancy and the remainder contributions paid. You explain that after all expenses and salaries are paid and you saved 2 years worth of operating costs any remaining profit will be given to C on a quarterly basis.

Law

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax organizations organized and operated exclusively for charitable or other exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization operates exclusively for 501(c)(3) purposes only if it engages primarily in activities that accomplish such purposes. It does not operate exclusively for 501(c)(3) purposes if more than an insubstantial part of its activities does not further such purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(1)(iii) Example (2) of the regulations provides the example of an art museum that exhibits and sells the art of unknown artists. The art is offered for sale under a consignment agreement. Under the agreement when the art is sold the museum retains a percentage of the proceeds to cover the costs and gives the rest to the artist. The museum is governed by a board of trustees unrelated to the artists. The artists in this situation directly benefit from the exhibition and sale of their art. As a result the museum's activity serves the private interest of these artists.

Section 1.501(c)(3)-1(e)(1) provides that an organization may meet the requirements of section 501(c)(3) if it operates a trade or business that is in furtherance of its exempt purposes but not if it is operated for the primary purpose of carrying on an unrelated trade of business as defined in section 513 of the Code.

Section 1.502-1(a) of the Regulations provides that in the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption

is not allowed under section 501 on the ground that all profits of such organization are payable to one or more organizations exempt from taxation under section 501.

Section 502(b)(2) provides that the term 'trade or business' shall not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

Section 1.513-1(d)((2) of the Regulations states that a trade or business is "related" to exempt purposes only where the conduct of the business activities has causal relationship to the achievement of an exempt purpose (other than through production of income), and is substantially related for purposes of section 513 of the code only if the casual relationship is a substantial one. Thus for the conduct of trade or business to be substantially related to the purposes for which exemption is granted, the production of goods or the performance of services must contribute importantly to the accomplishment of those purposes.

Revenue Ruling 71-395 1971-2 C.B. 228 held that a cooperative art gallery formed and operated by a group of artists for the purpose of exhibiting and selling their works does not qualify for exemption under section 501(c)(3) of the Code.

Revenue Ruling 73-127, 1973-1 C.B. 221 holds that a nonprofit organization that operates a retail grocery outlet and allocates a small portion of its earnings to provide on the job training to hard core unemployed individuals does not qualify for exemption from income tax. It was ruled that although the nature of the job training in this case is primarily on the job training and thus requires the existence of an operating business as its campus, the size and manner of the operation of the store as a retail grocery outlet is in itself an independent objective of the organization. It is conducted on a scale larger than is reasonably necessary for the performance of the organization's training program and was not intended to, nor does it fact, serve solely as a vehicle for carrying out the training program of the organization.

Revenue Ruling 73-128 1973-1 C.B. 222 held that an organization that is otherwise qualified for exemption from income tax will not fail to qualify merely because its education and vocational training of unemployed and under-employed individuals is carried out through the manufacturing and selling of toy products.

Revenue Ruling 76-94, 1976-1 C.B. 171 holds that an exempt organization's operation of a retail grocery store as part of its therapeutic program for emotionally disturbed youth, almost fully staffed by the adolescents, and on a scale no larger than is reasonable necessary for the performance of the organization's exempt functions, is not unrelated trade or business under section 513 of the Code.

Revenue Ruling 76-152 1976-1 C.B. 151 held that a nonprofit organization formed by

art patrons to promote community understanding of modern art trends by selecting for exhibit, exhibiting, and selling art works of local artists, retaining a commission on sales less than customary commercial charges and not sufficient to cover the cost of operating the gallery, does not qualify for exemption under section 501(c)(3) of the Code; Rev. Rul. 71-395 clarified.

Revenue Ruling 80-106, 1980-1 C.B. 113, held an organization that operates a thrift shop that sells items that are either donated or received on consignment and where substantially all of the work in operating the thrift shop is performed without compensation, and all profits are distributed to section 501(c)(3) organizations is not a feeder organization described in section 502(a) of the Code and qualifies for exemption as an organization operated for charitable purposes.

In Better Business Bureau v. United States, 316 U.S. 279 (1945), the Supreme Court held that an organization was not organized and operated exclusively for charitable purposes. The court stated that the presence of a single non-exempt purpose, if substantial in nature, will destroy exemption regardless of the number or importance of truly exempt purposes.

In Old Dominion Box Co. v. United States, 477 F.2d 344 (4th Cir. 1973) cert. Denied 413 U.S. 910 (1973) the court held that operating for the benefit of private parties constitutes a substantial non-exempt purpose.

In B.S.W. Group, Inc v. Commissioner, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial business.

In Airlie Foundation v. I.R.S., 283 F Supp. 2d 58 (D.D.C. 2003), the District Court found that the organization was formed principally to organize, host, conduct and sponsor educational and other charitable functions at its facilities. The organization's patrons were not limited to tax-exempt entities, but included patrons of a private and corporate nature. The organization paid significant advertising and promotional expenses and derived substantial income from the weddings and special events held at its conference center. The court determined that the organization's activities competed with a commercial nature and purpose. The court concluded that although the organization carried out a number of charitable and educational activities, these were incidental to its primary purpose of operating a for-profit conference center.

Application of Law

You do not meet section 501(c)(3) of the Code because you are not operated exclusively for a section 501(c)(3) purpose and because you failed to establish that your earnings will not inure to the benefit of B. You do not operate your consignment shop in a non-profit charitable manner. B controls your daily operations and may benefit from

the profits of the consignment shop.

You are not as described in section 1.501(c)(3)-1(c)(1) because your primary activity is the operation of a commercial business, specifically a consignment store. You are not primarily charitable, because the training you provide to special needs individuals is limited and clearly not your primary activity.

You are not as described in section 1.501(c)(3)-1(d)(1)(ii) of the regulations because you failed to establish your operations will not serve the private interests of your creator, B through her control and influence. B's hobbies include garage sales and consigning clothing. You have failed to establish that the operation of a store is charitable or more than an extension of B's hobbies.

You are similar to the example in Section 1.501(c)(3)-1(d)(1)(iii) of the regulations because more than an insubstantial part of your operations serve private interests. Specifically like the artists in the example who benefit from the sale of their artwork consignors benefit by your sale of their merchandise.

You are not as described in Section 1.501(c)(3)-1(e)(1) of the regulations because your operation of a consignment shop is not exclusively in furtherance of 501(c)(3) purposes but instead is a primary purpose to operate a business.

Even though you intend to turn over future profits to an exempt organization, as noted in section 1.502-1(a), because your primary purpose is carrying on the business of operating a consignment store, exemption is not allowed.

You are not as described in section 502(b)(2) because substantially all of the work performed in the consignment shop is performed with compensation. B performs substantially all the work and other employees will be hired and compensated in the future.

You are not described in section 1.513-1(d)(2) of the Regulations because your consignment sale business does not contribute importantly to the accomplishment of exempt purposes. Instead the business is primarily operated to sell merchandise on consignment. Trainees work a maximum of 2 hours out of an eight hour day and much of the training is provided by C, not you. Accordingly, your focus is clearly on the sale of merchandise, not training.

Like the organization in Revenue Ruling 71-395 you too are formed to exhibit and sell. Like the artists, your consignors benefit from the sale of their merchandise. See also Revenue Ruling 76-152.

You are similar to Revenue Ruling 73-127. You too operate a business on a scale

larger than necessary for the accomplishment of a training program.

You are not similar to Revenue Ruling 73-128 because education and training are not your primary activity. Instead your primary activity is the operation of a consignment store in a commercial manner.

You are not similar to Revenue Ruling 76-94 because the manner in which your consignment store is operated on a scale larger than necessary for the performance of your limited training program.

You are not similar to Revenue Ruling 80-206 because substantially all the work performed in your consignment shop is performed with compensation. In addition you will not distribute any profit to C until you have saved two years worth of operating costs and have paid all expenses and salaries.

You are similar to organization in the Better Business Bureau because you operate for the substantial non-exempt commercial purpose of operating a consignment shop in a commercial manner.

You are similar to Old Dominion Box because private parties, your consignors benefit from your sale of their merchandise and that benefit is a substantial non-exempt purpose.

You are similar to BSW Group because you too are primarily engaged in a business ordinarily carried on by for profit commercial businesses.

You are similar to Airlie because the facts show your consignment shop business is operated in a commercial manner. Your location and hours of operation are comparable to similar businesses operating for a profit. The manner in which you secure merchandise and price your merchandise is also comparable to similar businesses. You operate with paid staff. Training is limited to 2 hours a day and your involvement in the actual training of the individuals is limited as C conducts most of the training for the individuals. Accordingly, operating in a commercial manner is your primary activity.

Applicant's Position

Currently you are not making enough to be able to pay the special needs individuals. Once sales allow you to meet your budget that includes rent, utilities and salaries for B and the accountant you will pay the special need individuals who are doing volunteer training. You could have decided to be for-profit. However the special needs individuals would not be able to volunteer in your store.

You decided to be a non-profit separate from C because C has enough financial debt without trying to fund a small business like you. B has spent her own savings to start you and is currently making less than B would working at C.

You chose consignment instead of donation because people donate items that are not nice enough for consignment and you wanted a nice environment for the special needs individuals and B to work in.

Service Response to Applicant's Position

Compensating the trainees in the future will not overcome the fact that you operate a consignment store in a commercial manner as your primary activity. Likewise, the fact that B is now making less money or spent her savings to start you does not overcome the fact that you operate in a commercial manner. Your choice of consignment over donation because you wanted a nice environment to work in does not demonstrate an exempt purpose.

Conclusion

You do not qualify for exemption as an organization described in section 501(c)(3) for the following reasons any one of which standing alone is sufficient cause for denial.

You operate in a commercial manner.

You operate for more than insubstantial benefit to consignors. You sell consignors merchandise and share the proceeds from the sale with them.

You have failed to establish that B will not benefit from your operation.

Accordingly, we conclude you do not qualify for exemption under section 501(c)(3) of the code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts

(item 4) must be accompanied by the following declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Holly O. Paz
Director, Exempt Organizations
Rulings and Agreements

Enclosure: Publication 892